

TWELVE STEPS TO ASSURE A SUCCESSFUL FINANCING, SALE OR IPO

By Valerio L. Giannini

The basic error made by most private companies is not beginning early enough to prepare for a private financing, initial public offering (IPO) or outright sale. The result is untold millions left on the table, or worse, transactions never consummated.

The steps described herein won't preclude the pitfalls that plague the process of actually finding investors, buyers or underwriters or negotiating a deal. That's another list. Rather the steps described here are ones that can and should be taken long before that process begins.

The seeds of a successful private financing, IPO or sale are sewn years in advance. Although IPOs, sales, and financings are each distinctly different processes, the people signing the checks ultimately all need to see the same basic things in or about a company, irrespective of the type of transaction.

The following are steps that don't cost a lot, but can make a huge difference.

1. CLEAN UP THE BALANCE SHEET

The first financial statements given to potential investors or buyers set the stage. Subsequent revisions are at best viewed with skepticism. If owners want to pull out excess cash or retain personal ownership of real estate, equipment, copyrights or patents, get them off the balance sheet now.

Loans to the company from shareholders should be replaced by bank debt, even if the shareholder has to pledge the company's payoff as additional collateral for the new bank loan. Receivables due from officers or shareholders should also be cleared up.

2. DO TAX & ESTATE PLANNING NOW

Taxes can total over 50% of the proceeds of a sale, and inheritance taxes can take over half of what's left.

Devastating tax bills down the road can be significantly reduced. Electing to be taxed as a subchapter S corporation, if qualified, can make a big difference if done early enough, as can transferring stock or assets to trusts, partnerships or family members early, while values are defensively lower. Six months before going public or selling at \$10/share is not the time to try to move stock out at \$2.

Estate planning may require some restructuring, but It's a shame to have ten years of future profits go to pay inheritance taxes, or worse to have to sell the business.

3. HAVE AUDITABLE FINANCIALS

Audited financials add value and may make the difference between doing the deal or not. (For almost all IPO's at least two full years of audited statements are mandatory.)

If your financials aren't audited, at a minimum have a credible CPA observe year-end inventory and file it away. The cost is nominal, and it usually makes a retroactive audit possible if other accounting records are in order.

A "big five" auditor adds perceived quality and value, but count most in an IPO. Some will give emerging companies reasonable "starter" rates. It doesn't cost to ask. Established regional auditors can do the same job, usually with less bureaucracy and lower fees. The trade-off is prestige and image. Also remember that auditors don't necessarily replace your accountants.

4. MANAGE THE INCOME STATEMENT

Investors, buyers and underwriters all look for consistent earnings and growth. Peaks and valleys make them nervous.

Earnings and growth to a degree can be managed within the bounds of generally accepted accounting principles (GAAP). Tax deferral is no longer the main objective.

Spikes and dips in year to year profits reduce credibility and value, but in a smaller company can be smoothed out by increasing or decreasing reserves, giving or postponing bonuses or capitalizing or expensing, where the option exists.

Also, within bounds of accounting rules it is perfectly legitimate for financial reports to be different from tax returns.

Income statements can be "recast" after the fact to add back discretionary expenses such as excess owners' compensation and perks. If an IPO is the objective, however, high-ticket perks should be eliminated now because you can't use recast financials in an IPO. Every \$1 spent in a year can reduce the value of the company in an IPO by \$10, \$15 or more.

If private investment or sale is a more likely goal, at least keep discretionary expenses readily identifiable so recast statements are easy to track and reconcile. Try recasting past years now to see how they look.

5. FILL GAPS IN MANAGEMENT

Most investors, underwriters and buyers consider management their top priority.

Fill gaps in management, either internally or from the outside, sooner rather than later, and give people already on board the right titles. Companies with no Vice Presidents make management look thin, and managers with 60 days tenure aren't particularly inspiring. Also, credentials are important. Blue chip business pedigrees add value, other things being equal.

Also, there should be at least the blueprint of a succession plan in place, and senior management should have meaningful and well thought-out answers as to their future intentions and expectations.

Key executives should have professionally prepared employment, option and incentive agreements in place before discussions start. Seek outside help to determine what's customary given your circumstances and considered acceptable to investors, buyers or underwriters.

Also, consider using "phantom" stock instead of conventional options or issuing actual shares, but in either case have a clear understanding as to how vesting will be affected by a sale or change of control.

6. ADD OUTSIDE DIRECTORS

Outside directors are an economical way to obtain valuable advice, contacts and insight from the objective perspective of people not involved in the day to day crunch.

For an IPO, "name" outside directors with attention-getting credentials, affiliations or accomplishments enhance perceived value and marketability. They should not, however, have just joined the board and should own some stock or at least options.

Finding and recruiting the right outside directors requires focused time and effort. Also, easing friends and family lacking ownership or bona fide business credentials off the board should be done, but is delicate and can require more time than you think.

A "name" law firm can also add credibility and value, and a "name" firm attorney on the board is a plus, if they will do it. The trade-off is that they can be overly conservative as well as expensive.

If your present attorney isn't seasoned in securities transactions or acquisitions, meet with one or more others respected in the financial circles in which you anticipate dealing. Then try one for some nominal corporate work before you really need them.

7. RAISE THE COMPANY'S PUBLIC PROFILE

Good, credible, business publicity beyond just trade press adds value.

A smaller but interesting private company can orchestrate more coverage in the business press than it would ordinarily expect. Local newspapers and business publications are

good, but many relatively small companies also show up in national publications, such as Inc., Forbes, and Business Week; and not by accident.

Enlist the services of a financial or business PR firm or consultant who knows the ropes, or make it a priority and do it yourself.

Also, household name customers, the more the better, add perceived credibility, even if they only account for a small percentage of sales. Have as many as you can.

8. POSITION THE COMPANY FOR THE RIGHT COMPARISONS

Investors and buyers judge by comparison.

Maintain a running comparison of your operating and financial statistics vs. those of your peers and competitors. Prospectuses, IOK's and annual reports are excellent sources, as are trade associations and bankers' industry profile books.

A fair comparison may require changing your accounting categorizations. If so, do it before giving out financials showing unfairly, for example, that your gross margins don't measure up to others in your industry.

Study security analysts' reports on companies in your industry and determine:

a) which similarities you want to reinforce, b) which you should distance yourself from; and c) how to accomplish that.

Also, try to determine a range of values for your business in the context of a sale, financing or IPO, based on what you can glean from public and trade sources. Do not, however, fall into the trap of believing your company will be valued at the same multiple as public companies many times its size and/or with other significantly different characteristics.

9. DOCUMENT THE COMPETITION

Many company descriptions or business plans lack a truly realistic assessment of the competition. Investors can sense when a company is in denial. A product or service with no meaningful competition is extremely rare. Even if it is unique, there usually are or will be alternatives to fill the need.

Accordingly document the facts on actual and potential competitors and an objective comparison of similarities and differences, strengths and vulnerabilities, in a form understandable by someone outside your industry and believable by someone in it.

10. EXAMINE YOUR COMPANY AS INVESTORS WOULD

Be the first to do "due diligence" on your own company. Investors, buyers and underwriters all have comprehensive evaluation screens that go well beyond financial records.

Put your company through such a process before an investor does. Make it one that covers operations, marketing, personnel and technology as well as legal, regulatory, environmental, insurance, contractual, credit and accounting issues.

Have a professional outsider do it to make it objective, and develop a program to fix what the exercise indicates needs attention.

Contemplating an IPO? Make a dry run. Try drafting parts of a prospectus, providing the data required by SEC regs. The result will show what needs to be done and what will have to be disclosed when the time comes.

11. UNDERSTAND INVESTORS' NEEDS

Every investor, buyer or underwriter has certain criteria which they are not going to negotiate away. A buyer, lender or private investor has requirements for returns on investment or debt service; minority equity investors need an exit strategy, and underwriters a stock that's going to perform.

Specific criteria will vary by industry, the economy and the type of investor, but they are always there. Understanding such criteria well before negotiations begin will give you time to arrange things to maximize the probability of a transaction meeting both your objectives and the investor's or buyer's needs.

12. BE PREPARED FOR THE UNSOLICITED APPROACH

Unsolicited approaches by bona fide buyers do occur, and range from bargain hunters to the opportunity of a lifetime. Since the latter are usually motivated by a buyer's or investor's immediate needs or circumstances, they tend not to wait around.

In addition to the eleven steps described above, you can prepare yourself by having established relationships with financial advisors who know your business, whom you trust and to whom you can turn for counsel on a quick reaction basis.

Even with an offer in hand, it's seldom downhill to the finish line. An expression of interest or an offer is just the beginning of the process. How it's handled can make a huge difference in how it turns out.

Even the largest corporations almost invariably retain an investment banker as a financial advisor (in addition to attorneys and accountants), even when they already know the investor or buyer.

Companies that don't already know or aren't known in the investment banking community should establish relationships before they need them. These can range from just becoming acquainted to using them as financial advisors to work with the company on some of the steps described herein.

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Mr. Giannini began his Wall Street career with Kidder, Peabody & Co. and was also with Cumberland Investment Group in New York. He has been a principal or intermediary in over 40 corporate purchase or sale transactions and served as CEO or COO of three public and three private companies in transition.

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